

STATE OF NEW YORK

DIVISION OF TAX APPEALS

| | | |
|---|---|---------------|
| | : | |
| In the Matter of the Petitions | : | |
| | : | |
| of | : | |
| | : | |
| 1230 PARK ASSOCIATES | : | |
| AND CRYSTAL MANAGEMENT, INC. | : | DETERMINATION |
| | : | |
| for Revision of Determinations or for Refunds | : | |
| of Tax on Gains Derived from Certain Real | : | |
| Property Transfers under Article 31-B of the | : | |
| Tax Law. | : | |

Petitioners, 1230 Park Associates and Crystal Management, Inc., c/o Houlihan Parnes, 455 Central Park Avenue, Scarsdale, New York 10583, filed petitions for revision of determinations or for refunds of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law (File Nos. 801899 and 802197).

A hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on June 19, 1986 at 1:15 P.M., with all briefs to be submitted by March 31, 1987. Petitioners appeared by Lowenthal, Landau, Fischer & Ziegler, P.C. (Stephen S. Ziegler and Wayne J. Birschback, Esqs., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUES

I. Whether the Audit Division's assertion that the purchase price of certain shares of a cooperative housing corporation acquired by petitioners should be based on an allocation of petitioners' cost for the property rather than the corporation's cost for such property was proper.

II. Whether mortgage indebtedness should be allocated to and included in the selling price of certain shares of a cooperative housing corporation as sold by petitioners.

III. Whether petitioners should be allowed to reduce the amount of gain subject to tax by allowance of certain estimated costs denominated "negative carry".

IV. Whether petitioners have established that penalties asserted for failure to timely file certain returns and failure to timely remit tax due should be abated.

FINDINGS OF FACT

On June 19, 1986, authorized representatives for petitioners (Stephen S. Ziegler, Esq.) and for the Audit Division (Paul A. Lefebvre, Esq.) executed a Stipulation of Facts pertaining to the matters at issue. This Stipulation, modified herein only insofar as to delete references to various documents included with the stipulation as exhibits (the existence and authenticity of which documents are not disputed), provides as follows:

1. 1230 Park Associates ("1230") is a New York general partnership with offices at 55 East Hartsdale Avenue, Hartsdale, New York 10530.

2. Crystal Management, Inc. ("Crystal") is a New York corporation with offices at 238 East 53rd Street, New York, New York 10022.

3. As of August 1, 1979, Crystal was the owner of the fee (the "Fee") of the premises 1230 Park Avenue, New York, New York (the "Property").

4. On August 31, 1979, Crystal and 1230 entered into a Lease Agreement for the Property, with Crystal as the landlord and 1230 as the tenant (the "Leasehold").

5. On September 10, 1982, 1230 entered into a Contract of Sale to sell the Leasehold to 1230 Park Owners, Inc. (the "Corporation").

6. On September 14, 1982, Crystal entered into an Option Agreement (the "Option Agreement") with 1230 whereby 1230 was granted the option (the "Option") to purchase the Property only in connection with the planned conversion of the Property to cooperative ownership and a simultaneous transfer of the Property to a cooperative housing corporation and for no other purpose.

7. On June 2, 1983, Crystal and 1230 entered into a Participation Agreement (the "Participation Agreement") whereby they agreed that the aggregate price paid by the Corporation for the Property would be allocated 47.37 percent to Crystal for the Fee (\$3,881,773) and 52.63 percent to 1230 for the Leasehold (\$4,312,809).

8. On June 2, 1983, 1230 entered into an Assignment and Assumption of Option Agreement with the Corporation whereby 1230 assigned the Option to the Corporation.

9. On June 2, 1983, 1230 entered into an Assignment and Assumption of Lease with the Corporation whereby 1230 assigned the Leasehold to the Corporation.

10. On June 2, 1983, Crystal transferred by deed subject to 1230's Leasehold, the Fee of the Property to the Corporation.

11. Accordingly, as of June 2, 1983 (the "Closing Date"), the Corporation became the owner of all rights, title and interest in the Property.

12. The assignments and transfers made by 1230 and Crystal, hereinafter sometimes collectively referred to as the "Transferors," on the Closing Date in respect to the Property were made pursuant to a plan of cooperative ownership accepted for filing by the New York Attorney's General Office on November 30, 1982 and thereafter amended (the "Plan").

13. In consideration for the transfers of the Property, the Corporation paid an aggregate sales price to the Transferors of \$8,194,582. The price was paid as follows:

(a) the Corporation issued a purchase money mortgage of \$2,500,000 to the Transferors (the "Mortgage") secured by a first mortgage on the Property; and

(b) the Corporation paid to the Transferors \$5,694,582 which was the net proceeds realized by the Corporation upon the issuance of its shares less certain offering expenses and reserves paid or withheld therefrom.

14. A total of 12,730 shares (the "Shares") of capital stock of the Corporation were allocated in blocks to 79 residential apartments and issued by the Corporation.

15. On or shortly after the Closing Date, individual subscribers (the "Subscribers") made capital contributions to the Corporation totalling \$4,147,488 in exchange for 6,308 Shares.

16. Of these 6,308 Shares, 3,970 were subscribed to after March 28, 1983 and 2,338 were

subscribed to prior to that date.

17. The Transferors made capital contributions to the Corporation for the remaining 6,422 issued Shares (the "Unsold Shares") of \$2,314,444 and the Unsold Shares were issued to the Transferors as tenants-in-common.

18. Consistent with the Participation Agreement, the purchase price for the Unsold Shares was paid 47.37 percent by Crystal and 52.63 percent by 1230.

19. The net proceeds from the issuance of the Corporation's Shares paid to the Transferors as part of the sales price were as follows:

| | |
|--|--------------------|
| Gross Proceeds | \$5,694,582 |
| Less: Reserve Fund | (225,000) |
| Less: Offering expenses - i.e., expenses of issuing shares and acquiring the Property | (1,322,094) |
| NET PROCEEDS | <u>\$4,147,488</u> |

The offering expenses were as follows:

Acquisition Costs

| | | |
|--------------|---------------|------------|
| Mortgage Tax | \$ 56,250 | |
| Transfer Tax | 172,740 | |
| Title Costs | 26,182 | |
| Legal Fees | 95,525 | |
| Other | <u>66,188</u> | |
| | | \$ 416,885 |

Other Offering Expenses

| | | |
|---|---------|--------------------|
| Title Costs (including title insurance and recording charges) | 254,772 | |
| Printing Costs | 18,031 | |
| Sales Commissions (actual commissions of \$170,502 plus estimated antici- pated commissions of \$341,387) | 511,889 | |
| Legal Fees | 53,806 | |
| Filing Fees | 10,675 | |
| Engineering Fees | 5,250 | |
| Accounting Fees | 12,000 | |
| Appraiser's Fee | 2,000 | |
| Other Offering Expenses Advanced by Sponsor prior to Closing | 36,786 | |
| | <hr/> | <u>905,209</u> |
| | | <u>\$1,322,094</u> |

20. From the Closing Date through October 26, 1984, the Transferors made sales of 592 Unsold Shares.

21. In preparing their gains tax returns (the "Initial Returns") with regard to transfers of the 592 Unsold Shares, the Transferors calculated their purchase price for the Unsold Shares with reference to the Corporation's original cost for the Property. They computed the Corporation's cost for the property as follows:

| | | |
|-------------------------------------|--------|-------------------|
| Purchase Price | | \$8,194,582.00 |
| Add: Acquisition Costs | | <u>416,885.00</u> |
| Total Purchase Price to Corporation | | \$8,611,467.00 |
| Divided by Total Number of Shares | 12,730 | |
| Purchase Price Per Share | | \$ <u>676.47</u> |

22. In preparing the Initial Returns with regard to the 592 Unsold Shares, the Transferors did not include any part of the \$2,500,000 Mortgage on the Corporation's Property in the sales price for the Unsold Shares.

23. In an audit, the Department of Taxation and Finance made the following determinations:

(a) The Transferors should be taxed on the sales of 6,308 Shares made by the Corporation on the Closing Date, of which 3,970 were deemed taxable as having been made pursuant to subscription agreements entered into after March 28, 1983.

(b) The purchase prices of Crystal and 1230 for the Shares should be their purchase prices for their respective interests in the Property before transfer of the Property to the Corporation and that these purchase prices were as follows:

| <u>Total</u> | | <u>Per Share</u> <u>(12,730 Shares)</u> |
|--------------|--------------------|--|
| Crystal | \$2,035,253 | \$159.88 |
| 1230 | <u>873,147</u> | <u>68.59</u> |
| TOTAL | <u>\$2,908,400</u> | <u>\$228.47</u> |

(c) The Transferors should include an allocable portion of the \$2,500,000 Mortgage on

the Corporation's Property in the sales price of the Shares as follows:

| | <u>Total</u> | <u>Per Share</u> |
|---------|--------------------|------------------|
| Crystal | \$1,184,272 | \$ 93.03 |
| 1230 | <u>1,315,772</u> | <u>103.36</u> |
| TOTAL | <u>\$2,500,044</u> | <u>\$196.39</u> |

24. The Transferors conceded that the non-grandfathered sales of a total of 3,970 Shares made by the Corporation are subject to the gains tax (Finding of Fact "23[a]"). Pursuant to an agreement, the Transferors will pay the tax on said sales on behalf of the Corporation. In regard to the penalties assessed on the transfers, the Transferors take the position that the taxpayer for these sales was the Corporation.

25. As set forth in Finding of Fact "27" below, the Transferors are protesting the determinations set forth in Findings of Fact "23(b) and (c)" in arriving at the gains tax deficiency.

26. On the basis of the aforesaid determinations, the Department asserted a deficiency on sales of the 4,562 Shares (the 3,970 "non-grandfathered" plus 592 "unsold shares") as follows:

| <u>Sales Price</u> | <u>Crystal</u> | <u>1230</u> | <u>Total</u> |
|---|----------------|----------------|----------------------------|
| Actual | \$1,533,401 | \$1,703,671 | \$3,237,072 |
| Proration of Corporation's Mortgage | <u>424,530</u> | <u>471,670</u> | <u>896,200¹</u> |
| \$1,957,931 | \$2,175,341 | \$4,133,272 | |

¹Due to rounding differences, this is not the exact figure includible on a per Share basis. The exact figure is \$895,931; that is, \$196.39 per Share x 4,562 Shares sold.

| | | | |
|---|--------------------|--------------------|-----------------------------------|
| Less: Purchase Price (approximately \$159.88 per Share for Crystal and \$68.59 per Share for 1230) | (<u>729,038</u>) | (<u>312,742</u>) | (<u>1,041,780</u>) ² |
| Gain \$1,228,893 | \$1,862,599 | \$3,091,492 | |
| x Rate of Tax | x <u>10%</u> | x <u>10%</u> | x <u>10%</u> |
| Gains Tax | \$ <u>122,889</u> | \$ <u>186,260</u> | \$ <u>309,149</u> |
| Less: Tax Paid | (<u>17,185</u>) | (<u>19,093</u>) | (<u>36,278</u>) |
| Deficiency | \$ <u>105,704</u> | \$ <u>167,167</u> | \$ <u>272,871</u> |

27. The Transferors paid the foregoing deficiency under protest.

28. By Notice of Determination of Tax Due dated January 23, 1985, the Department assessed penalties and interest against the Transferors in the amount of \$90,047.43.

29. In March 1985, the Transferors filed a claim for refund (the "Initial Refund Claim") in the amount of \$251,927, together with the interest that had accrued thereon, as follows:

| | |
|------------------------|------------------|
| Crystal | \$ 95,782 |
| 1230 | <u>156,145</u> |
| Total Claim for Refund | <u>\$251,927</u> |

30. The Transferors' Initial Claim for Refund was based upon the following two grounds (hereinafter referred to as the "Basic Issues"):

(a) the Corporation's Mortgage should not be included in the sales price for the Shares, and

(b) the Transferors' purchase price for the Shares should be determined by making an allocation of the Corporation's cost for the Property, rather than an allocation of the Transferors' cost for the Property prior to transfer of the Property to the Corporation.

31. By letter dated April 3, 1985, the Department denied the Initial Refund Claim.

32. On June 6, 1985, the Transferors filed a petition (the "Original Petition") with the

²Due to rounding differences, this is not the exact figure that would be determined on a per Share basis. The exact figure would be \$1,042,280; that is, \$228.47 x 4,562.

State Tax Commission for a redetermination of the decision of the Department denying their Initial Refund Claim.

33. The Transferors filed their returns, the Department conducted the audit, and the Transferors made the above calculations in the Initial Refund Claim on the basis of a method promulgated by the Department in TSB-M-83(2), referred to as Option A. Under Option A, the gain on a particular sale of shares is determined with respect to the actual sales price of such shares.

34. In the Initial Refund Claim, the Transferors reserved the right to file a supplemental application for refund of gains tax making calculations on the basis of Option B. Under Option B, the gain on a sale of shares is determined with respect to the estimated gain per share which the transferor estimates it will realize on all taxable sales.

35. On October 21, 1985, the Transferors filed an amended return (the "First Amended Return") calculated under Option B in regard to the sales of 4,564³ Shares reported in the Initial Returns as well as an additional 250 Shares sold since that time.

36. In a letter supplementing the First Amended Return (submitted after a meeting on November 25, 1985 attended by the Transferors' representative and representatives of the Department), the Transferors requested that the \$35,286 gains tax overpayment be applied to a refund in the amount of \$12,008 to Crystal

³The agent's audit report listed sales of 4,562 Shares. This was a mathematical error. In fact, 4,564 Shares have been sold.

and a credit in the amount of \$23,278 against gains tax arising from sales of Shares in the future.⁴

37. On December 3, 1985, the Transferors filed a supplemental petition with the State Tax Commission (the "Supplemental Petition"), along with a second amended return (the "Second Amended Return"), in regard to the sales of 4,814 shares reported in the First Amended Return.

38. The Supplemental Petition and the Second Amended Return were based on:

- (a) the use of Option B;
- (b) the Transferors' position on the Basic Issues; and
- (c) claiming a further deduction under Tax Law § 1440.5 for the "Negative Carry" as discussed hereinafter.

The Audit Division does not concede the accuracy of the amounts used for the calculation or the validity of the legal basis for the Negative Carry.

39. In regard to the Negative Carry, the Transferors are seeking in the Second Amended Return to have included in their deductible costs for converting the Property to cooperative ownership (under Tax Law § 1440.5) the loss incurred and to be incurred by the Transferors in carrying the Unsold Shares (the "Negative Carry") from September 4, 1983 (which was after the Closing Date of the transfer of the Property to the Corporation) through the estimated date of sale of the Unsold Shares.

40. The Transferors' claim for a Negative Carry is based on their presently incurring a net loss in holding the Unsold Shares. The costs incurred include maintenance charges to the Corporation, management fees, repairs, insurance and other expenditures directly related to the holding of the Unsold Shares. These costs exceed gross rental income received from the tenants of the apartments to which the Unsold Shares relate.

41. The Transferors' position on the Negative Carry includes assumptions as to the holding period of the Unsold Shares, e.g., 30 percent of the Shares would be sold as apartments become vacant after an average holding period of 48 months and 70 percent of the Shares would be sold occupied after an average holding period of 96 months. Similar assumptions have been accepted by the Department upon audit of other transferors for purposes of making estimates under Option B.

42. Pursuant to the Supplemental Petition and the Second Amended Return, the Transferors calculated their estimated gain per Share as follows:

| <u>CONSIDERATION</u> | <u>PRESENT</u> | <u>ESTIMATED</u> | <u>TOTAL</u> |
|--|----------------|------------------|--------------|
| Actual Non-Grandfathered Sales | \$3,684,272 | | \$3,684,272 |
| Estimated Future Sales [Mortgages taken over by Corporation omitted] | | \$3,458,360 | 3,458,360 |
| Less: Brokerage Fee - 4% | (147,371) | (138,334) | (285,705) |

⁴The \$12,008 to be refunded to Crystal arose from an adjustment to Crystal's purchase price. The balance of the overpayment, \$23,278, resulted from the conversion to Option B in calculating gains tax. The Transferors agreed to request the credit since it is the policy of the Department to allow credits rather than refunds as the result of overpayments arising from the conversion from Option A to Option B for purposes of calculating gains tax. The Transferors acquiesced to this policy without prejudice to their claim as set forth in Findings of Fact "43" and "45".

| | | | |
|---|--------------------|----------------------------|--------------------|
| CONSIDERATION | <u>\$3,536,901</u> | <u>\$3,320,026</u> | <u>\$6,856,927</u> |
| LESS: <u>COSTS</u> | | | |
| Purchase Price | \$8,611,467 | | \$8,611,467 |
| Other Acquisition Costs | | | |
| Capital Improvements ⁵ | [omitted] | \$68,000 | 68,000 |
| Expenses to Create Ownership in Cooperative Form ⁶ | [omitted] | <u>741,394⁷</u> | <u>741,394</u> |
| | \$8,611,467 | \$ 809,394 | \$9,420,861 |
| LESS: % of Costs Attributable to Grandfathered Shares (18.366%) | <u>1,581,582</u> | -0- | <u>1,581,582</u> |
| Cost Attributable to Taxable Shares | <u>\$7,029,885</u> | \$ 809,394 | <u>\$7,839,279</u> |
| Gain (Loss) (982,352) | | | \$ |
| Divided by Number of Taxable Shares (12,730 - 2,338 Grandfathered) | | | <u>10,392</u> |
| GAIN (LOSS) PER SHARE | | | \$ <u>(94.53)</u> |

43. On the basis of the Transferors' positions on the Basic Issues, but subject to Findings of Fact "44" and "45", the Transferors claimed refunds of gains tax in the Second Amended Return as follows:

| | | | |
|----------|--------------|-------------|----------------|
| | <u>Total</u> | <u>1230</u> | <u>Crystal</u> |
| Tax Paid | \$322,326 | \$152,928 | \$169,398 |

⁵Since this claim for refund is calculated on the basis of the Corporation's cost for the Property, these expenditures exclude the capital improvements made by the Transferors totaling \$486,630.

⁶Since this claim for refund is calculated on the basis of the Corporation's cost for the Property, these expenditures exclude the expenses to convert to cooperative ownership incurred by the Transferor totaling \$1,139,305.

⁷This item is the Negative Carry.

| | | | |
|---|-----------|-----------|-----------|
| Less: Tax due per Second Amended Return | (0) | (0) | (0) |
| Refund Claimed | \$322,326 | \$152,928 | \$169,398 |

44. Since the Transferors' method for calculating gain under Option B resulted in an estimated loss on sales of the Shares, if the determination (or the decision of the Tax Appeals Tribunal and/or the courts) is in favor of the Transferors on the Basic Issues then, at the Department's request, the Transferors have offered pursuant to the Supplemental Petition to forego calculation of gain on the basis of Option B and report gain on the basis of Option A.

45. On the basis of Option A and the Transferors' positions on the Basic Issues, the Transferors applied for refunds, together with the interest that accrued thereon, allocated between each of the Transferors as follows:

| | |
|---------|-----------------------|
| | <u>Refund Claimed</u> |
| Crystal | \$135,495 |
| 1230 | <u>115,261</u> |
| Total | <u>\$250,756</u> |

46. By letter dated March 10, 1986, the Department permitted an upward adjustment of \$317,535 to the original purchase price of Crystal. This upward adjustment of Crystal's purchase price reflected the difference between the fair market value of the Property (\$1,600,000) at the time it was acquired by Crystal and the amount originally allowed by the Department upon audit (\$1,282,465).

47. By letter dated May 21, 1986, the Department accepted the First Amended Return as a proper Option B filing and granted a refund (including interest) to Crystal of \$13,546⁸ in regard to the upward adjustment of Crystal's original purchase price (as described in Finding of Fact

⁸The \$13,546 consisted of a refund of \$11,384 gains tax plus interest of \$2,162. The gains tax refund was less than the \$12,008 applied for (see Finding of Fact "36") due to certain adjustments made by the Department and approved by the Transferors' counsel.

"46") and calculated gain per Share under Option B of \$552.28 to be reported on future sales of the Unsold Shares.

48. The refund granted Crystal (as described in Finding of Fact "47") was applied against the outstanding assessment of penalties and interest (as described in Finding of Fact "28") pending resolution of the penalty issue is the Division of Tax Appeals and/or the courts.

49. Consistent with the application of Crystal's refund against the penalty assessment, the Department issued a revised Notice of Determination of Tax Due, dated May 21, 1986, in the total amount of \$71,731.

50. As set forth in Finding of Fact "28", following the Transferors' payment of the deficiency set forth in Finding of Fact "26", the Transferors received a Notice of Determination of Tax Due, dated January 23, 1985, asserting penalties and interest against the Transferors in the amount of \$90,047.43. The Transferors filed a petition against this determination, which also serves as a petition against the revised Notice of Determination of Tax Due (as described in Finding of Fact "49").

51. The penalty related to 3,970 shares sold by the Corporation pursuant to subscription agreements entered into after March 28, 1983 (see___ Finding of Fact "16") and 592 shares sold (see___ Finding of Fact "20") by the Transferors after said date through October 26, 1984.

52. The Transferors and the Department agree that the issues are as follows:

Issue 1

- (a) Should the Corporation's mortgage be included in the Transferors' sales price for the Shares (as determined by the Department);
- (b) should the Transferors' purchase price for the Shares be determined by making an allocation of the Corporation's cost for the Property (as claimed by the Transferors), rather than an allocation of the Transferors' cost for the Property prior to transfer of the Property to the Corporation (as determined by the Department);

Issue 2

Should the Transferors be permitted a further deduction under Section 1440.5 for the estimated "Negative Carry" as set forth in Findings of Fact "39" through "41".

Issue 3

Did the Transferors have reasonable cause for not filing returns with respect to 3,970 Shares sold by the Corporation at or around the Closing Date and for excluding the mortgage in calculating gain on sales of 592 Unsold Shares.

53. The Transferors agree that if the Department wins on any legal issue, the Transferors concede that the gains tax should be calculated in regard to that issue as set forth in the First Amended Return. Thus, the Transferors concede the Department's figures on:

- (a) the cost to the Transferors for their respective interests in the Property which would be the cost for the Shares under the Department's position;
- (b) the allocation of the mortgage to each unit for inclusion in the sales price of the Shares under the Department's position.

54. The Department agrees that if the Transferors win on any legal issue, the Department concedes that the gains tax should be calculated in regard to that issue as set forth in the Second Amended Return. Thus, the Department concedes the Transferors' figures on amounts of:

- (a) the cost of the Property to the Corporation (applicable if the Transferors win Issue I);
- (b) the estimated Negative Carry subject to verification of estimates by the Audit Division and to adjustments based on the reporting requirements of Option B.

Additional Stipulated Facts

On March 18, 1987, the parties, by their duly authorized representatives executed a supplemental stipulation by which they agreed to certain additional facts (relating to petitioners herein), as follows:

55. Upon the transfer of the Property to the Corporation (the "Closing"), as set forth in the Substantive Stipulation (Finding of Fact "16"), the Corporation issued a total of 3,970 shares subject to Gains Tax to persons other than the Transferors (sponsors). The Transferors did not

file returns in regard to said sales of shares made by the Corporation prior to the audit which was held on October 26, 1984.

56. After the Closing, sales of shares were made by the Transferors on the following dates and returns with regard to such sales were filed on the following dates:

| <u>Apartment</u> | Number of Shares | Date Apartment <u>Sold</u> | Date Gains Tax Return <u>Filed</u> |
|------------------|---------------------|-------------------------------|---------------------------------------|
| 4A | 96 | 2/17/84 | 3/21/84 |
| 10A | 98 | 6/11/84 | 6/12/84 |
| 9A | 100 | 6/11/84 | 6/12/84 |
| 7A | 98 | 3/21/84 | 3/21/84 |
| 6A | 98 | 7/23/84 | 7/24/84 |
| 12A | <u>102</u> | 6/21/84 | 6/21/84 |
| TOTAL | <u>592</u> | | |

57. The sales of the 592 shares listed in the aforesaid table were made, and the returns with respect thereto were filed, prior to the date of the audit.

58. A schedule attached to the first return filed by the Transferors reflected the Transferors' position in regard to Issues I and II by using the Corporation's cost as the purchase price for the Property and excluding from the sales price of the shares the Mortgage payable by the Corporation.

CONCLUSIONS OF LAW

A. That Tax Law § 1441, which became effective March 28, 1983, imposes a tax at the rate of ten percent upon gains derived from the transfer of real property within New York State.

B. That petitioners argue that in determining gain, the cooperative housing corporation's (CHC's) cost rather than petitioners' (sponsors') cost is the appropriate measure of original purchase price to be allocated to the shares. Petitioner asserts, in essence, that the co-oping process should consist of two (potentially) taxable events, namely (1) the transfer (closing) into the cooperative housing corporation and (2) transfers of shares allocated to the individual apartment units.

C. That petitioners' argument (in essence for a "stepped basis") does not pass muster in light of the Court of Appeals decision in *Mayblum v. Chu* (67 NY2d 1008 [1986]). In *Mayblum*, plaintiffs sought a declaratory judgment "to establish that the transfer of real property underlying a cooperative corporation plan (the Gerard Towers transaction) [was] the taxable event under Tax Law Article 31-B...." The Court, however, ruled against plaintiffs, indicating in its decision that gains tax "is imposed by the Statute upon the overall cooperative plan...", that "...the overall transaction [is] taxable", and that "for purposes of computation of the tax the cooperative conversion is treated as a single transfer,..." (*Mayblum v. Chu*, *supra*, at 1009 [emphasis added]).

D. That in light of the foregoing, petitioners' argument in favor of utilizing a two transfer approach and basing gain herein on the CHC's cost must be rejected. The Court of Appeals, in essence, has described the entire co-oping process, for gains tax purposes, as one indivisible transaction, with tax to be computed in the sense of a single, overall transfer. Thus, to adopt petitioners' argument and break down into two steps what the Court in *Mayblum* concluded was to be treated as one transaction is not only unwarranted but, moreover, would appear to conflict directly with the Court's reasoning. Finally, petitioners make much of the fact that the Legislature did not adopt amendments to Article 31-B specifically setting forth the computational method utilized by the Audit Division, maintaining that this failure to specify such method as accepted is tantamount to rejection. By contrast, however, it would appear that the Legislature saw no need to further specify or clarify that in fact what it originally intended was being carried out in the Audit Division's method of computation in applying Article 31-B to the cooperative conversion process.

E. That with respect to the inclusion of mortgage indebtedness assumed by individual apartment unit purchasers (as allocated) as part of the consideration received by petitioners, such issue was decided by the State Tax Commission in *Matter of Palmer Equities* (State Tax Commn., December 13, 1985). In light of the foregoing discussion of *Mayblum*, and the attendant conclusion that there is no basis for treating the co-oping process as other than a single

transaction for gains tax purposes, petitioners' assertion that a mortgage from a CHC to a sponsor should be separately dealt with (as part of a two transaction breakdown) is rejected. The Audit Division's treatment of the mortgage indebtedness herein (as allocated) as consideration to petitioners is entirely consistent with the language of Tax Law § 1440.1(a) and the decisions in Mayblum (supra) and Palmer Equities (supra).

F. That Tax Law § 1440.5(a) provides as follows:

"'Original purchase price' means the consideration paid or required to be paid by the transferor; (i) to acquire the interest in real property, and (ii) for any capital improvements made or required to be made to such real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements. Original purchase price shall also include the amounts paid by the transferor for any customary, reasonable and necessary legal, engineering and architectural fees incurred to sell the property and those customary, reasonable and necessary expenses incurred to create ownership interests in property in cooperative or condominium form, as such fees and expenses are determined under rules and regulations prescribed by the tax commission." (Emphasis added. The last sentence of Section 1440.5(a) was effective September 4, 1984).

G. That the "negative carry" sought by petitioners represents the excess of maintenance and management costs over gross rents¹ for apartment units the shares to which have not been transferred to a cooperative apartment unit purchaser. Petitioners seek deduction for such excess (loss) during the period of time (herein estimated) until the shares to such units are purchased.

H. That the relevant statutory section (Tax Law § 1440.5[a]) speaks of "expenses incurred to create ownership interests in property in cooperative or condominium form..." (emphasis added). The applicable regulation, 20 NYCRR 590.39, provides a list illustrating examples of allowable costs. None of the costs therein illustrated as allowable is in the nature of those costs giving rise to the "negative carry" sought by petitioners. By contrast, the costs sought by petitioners are in the nature of ongoing expenses rather than expenses of creating ownership interests. The statute (and the regulation implementing and illustrating the same) speaks of costs of creating but not costs of carrying, and thus the costs forming the basis for the negative carry sought by petitioners are not costs allowable within the contemplation of the statute.

¹ It is undisputed that rent amounts are often limited under rent control and/or rent stabilization rules.

I. That Tax Law § 1446.2 provides, in part, that:

"[a]ny transferor failing to file a return or to pay any tax within the time required by this article shall be subject to a penalty of ten per centum of the amount of tax due plus an interest penalty of two per centum of such amount for each month of delay or fraction thereof after the expiration of the first month after such return was required to be filed or such tax became due, such interest penalty shall not exceed twenty-five per centum in the aggregate. If the tax commission determines that such failure or delay was due to reasonable cause and not due to willful neglect, it shall remit, abate or waive all of such penalty and such interest penalty."

J. That it is undisputed that the majority of returns required herein were not timely filed.

Moreover, as a result of the position taken by petitioners with respect to calculating their gains tax liability, the proper amount of tax was not timely remitted in connection with any of the transfers in question (including those for which timely, or near timely, returns were filed). In defense of such filing and payment record, petitioners point to the relative newness of the gains tax at the time of the subject conversion and to the questions surrounding the computation of tax and requirements for filing and remittance, specifically as raised with respect to cooperative conversions. Further, petitioners maintain that they relied completely upon their legal counsel as to the manner of handling any gains tax aspects of the conversion. In turn, noting the then nonexistence of judicial construction of the tax with respect to cooperatives, it is asserted that counsel's advice constituted a reasonably taken position with respect to the manner of computing tax and remitting amounts due. In this regard, petitioners also assert that their manner of filing clearly disclosed to the Audit Division the method of computation utilized by petitioners. Finally, petitioners note their reliance upon the advice received from the auditor, upon audit, that penalties could be avoided if petitioners paid the tax asserted as due and filed a claim for refund (rather than awaiting deficiency proceedings) at the conclusion of the audit.

K. That petitioners' assertions, centered essentially upon an interpretation of the law different from that taken by the Audit Division, do not establish that penalty is inappropriate and

do not support a conclusion that penalty should be abated. Initially it is noted that guidelines as to the taxability of cooperative conversions including, specifically, computational explanations, had been issued by the Audit Division and were available to the public well before the subject audit occurred.² Not only were such guidelines issued and the Audit Division's position made known before the audit herein, but there does not appear to have been any request by petitioners (or their counsel) to the Audit Division for enunciation or clarification of its position either before or after the June 2, 1983 closing into the cooperative housing corporation. Further, and specifically with respect to gains tax penalties, it has been held that "the failure to pay a tax due to a different legal interpretation of a statute need not be considered 'reasonable cause.' In fact, if it were so considered, [the Commissioner] would rarely if ever be entitled to levy such penalties." (Matter of Auerbach v. State Tax Commn., Sup Ct, Albany County, March 27, 1987, Williams, J.) Accordingly, the Audit Division's imposition of penalties herein was appropriate and is sustained. Finally, the auditor's statement, upon audit, that penalty would not be imposed if petitioners chose to pay the amount of tax determined on audit and seek refund rather than challenge a notice of determination, does not explain or justify petitioners' failure to

² Department of Taxation and Finance Publication 588, "Questions and Answers -Gains Tax on Real Property Transfers", was issued in August 1983. Question and Answer number 20 in such publication, as well as Technical Services Bureau Memorandum 83-2(4), issued on August 22, 1983, discussed the taxability of and set forth the filing requirements for transferors of cooperative units.
file and pay initially at the time of the transfers (or at any time thereafter prior to the audit).

L. That the petitions of 1230 Park Associates and Crystal Management, Inc. are in all respects denied.

DATED: Albany, New York
December 17, 1987

ADMINISTRATIVE LAW JUDGE